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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of	)	
	)	
Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services	)	CC Docket No. 95-20

COMMENTS OF
THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.

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THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.

The National Cable Television Association, Inc. ("NCTA"), by its attorneys hereby files comments in response to the Commission's Notice of Proposed Rulemaking[1] in the above-captioned proceeding. NCTA is the principal trade association of the cable television industry in the United States. NCTA represents cable television operators serving over 80 percent of the nation's cable television households and over 60 cable programmers, as well as equipment manufacturers and others interested in or affiliated with the cable television industry.

I. INTRODUCTION AND SUMMARY

For the second time in four years, the United States Court of Appeals for the Ninth Circuit has concluded that the FCC's scheme for regulating the provision of enhanced services by local exchange companies ("LECs") is flawed.[2] In particular, the Court has faulted the Commission for failing to adequately explain its decision to abandon the requirement that local telephone companies provide enhanced

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1 Notice of Proposed Rulemaking, Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services, CC Docket No. 95-20, FCC 95-48, released February 21, 1995 ("Notice").

2 California v. FCC, 39 F.3d 919 (9th Cir. 1994) (California III).

services through a structurally separate subsidiary in order to protect against LEC anticompetitive behavior.

On remand from the Court, the Commission has requested comment on whether structural separation should be reimposed for some or all Bell Operating Company ("BOC") enhanced services, presumably including enhanced services offered in conjunction with BOCs' video dialtone offerings. While the issue was not specifically raised in the Notice, this proceeding is also a logical forum to address the need for requiring local exchange carriers that provide video programming directly to subscribers to do so through a separate subsidiary. That requirement is necessary regardless of whether LEC provision of video programming (including the portion of the facility over which the programming is provided) is regulated under Title VI (as the statute requires) or if the Commission adopts its untenable proposal to regulate the LECs' video offerings under Title II.[3] As discussed below, in either circumstance, in order to detect and deter LEC anticompetitive behavior, the Commission must require local exchange carriers to conduct their Title VI cable operations or their Title II video programming offerings through a separate subsidiary.[4]

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3 As explained in detail in our Comments on the Commission's Fourth Further Notice of Proposed Rulemaking (at 8-33), telephone companies providing video programming directly to subscribers must do so pursuant to Title VI. Nevertheless, the Commission has suggested that LECs may do so pursuant to Title II -- a conclusion inconsistent with the command of the Communications Act. If the Commission permits telephone companies to provide video programming under a Title II regime, a LEC's provision of video programming should be done only through a structurally separate subsidiary. If a LEC providing video programming is deemed to be a cable operator regulated pursuant to Title VI (which we believe is the only permissible conclusion), the cable system facility and the cable services offered by the LEC cable operator over the facility, should be provided through a structurally separate subsidiary.

4 The Commission's structural separation requirement has been applied only to BOCs. However, given the dominance of each LEC in its service area and the necessity of

Local exchange carriers possess unique and indisputable incentives to utilize monopoly resources for the benefit of their competitive services. When LECs have a stake in the competitive video programming market, while at the same time providing common carrier services including video dialtone ("VDT") to others, they have even greater incentives and opportunities to engage in anti-consumer and anticompetitive behavior. LEC provision through a separate subsidiary of Title VI cable television operations and video programming pursuant to Title II (if permitted), as well as enhanced services, will increase the ability of regulators to deter telephone companies from acting upon these incentives to the disadvantage of consumers and competitors.

II. BACKGROUND

In 1980, the Commission decided not to regulate enhanced services under Title II of the Communications Act of 1934 (the "Act"). It determined, however, that to protect competitive providers adequately, BOCs must provide enhanced services through structurally separate subsidiaries.[5] The Commission concluded that structural separation increases the ability of regulators to detect LEC cross-subsidization and discrimination. The separate subsidiary requirement fulfills this function while imposing a significantly less burdensome regulatory role on the

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establishing effective safeguards against LEC anticompetitive conduct when they provide competitive video services, the Commission need not distinguish between BOCs and other LECs in requiring a separate subsidiary requirement unless and until presented with record evidence demonstrating that the requirement should not apply to certain LECs.

[5] Amendment of Section 64.702 of the Commission's Rules and Regulations (Computer II), 77 FCC 2d 384, 457-87 (1980) (Final Decision), recon., 84 FCC 2d 50 (1981) (Reconsideration Order), further recon., 88 FCC 2d 512 (1981) (Further Reconsideration Order), affirmed sub nom. Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983).

Commission than would be the case with non-structural safeguards. As the Commission stated:

> Although the subsidiary requirement does not alter incentives, it reduces the ability of dominant firms to engage in predation or to do so without detection. The principal mechanisms employed are the reduction in the extent of joint and common costs between affiliated firms, the requirement that transactions move from one set of corporate books to another, and, particularly apt where communications common carriers are concerned, the publication of rates, terms, and conditions on which services will be available to all potential purchasers. The result of requiring such arrangements in the commercial affairs of corporate affiliates may be to eliminate some competitive controversies and to narrow others, but it obviously does not foreclose the possibility of predatory conduct altogether. In reality, then, a separate subsidiary requirement is a pragmatic and moderate attempt to enable dominant producers or suppliers whose participation in a given market raises special problems to participate, while reducing the risks that their customers or competitors will be disadvantaged by such participation. It balances communications consumers' interest in open entry and full utilization of the telecommunications network and related facilities with their equally strong interest in not being the source of cross-subsidies and the victims of efficiency-reducing discrimination.[6]

Six years later, the Commission decided to abandon the separate subsidiary requirement and, in its place, to adopt a scheme of nonstructural safeguards. The Commission concluded that these safeguards would provide sufficient protection for competing enhanced service providers ("ESPs") and would avoid the inefficiencies associated with structural separation.[7]

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6 Id. at 462.

7 Amendment of Section 64.702 of the Commission's Rules and Regulations, (Computer III), CC Docket No. 85-229, Phase I, 104 FCC 2d 958 (1986) (Phase I Order), recon., 2 FCC Rcd 3035 (1987) (Phase I Reconsideration Order), further recon., 3 FCC Rcd 1135 (1988) (Phase I Further Reconsideration Order), second further recon., 4 FCC Rcd 5927 (1989) (Phase I Second Further Reconsideration), Phase I Order and Phase I Reconsideration Order vacated, California v. FCC, 905 F.2d 1217 (9th Cir. 1990)

The Ninth Circuit did not agree with the Commission's decision and, in 1990, it vacated three orders in the Computer III proceeding.[8] It held that the Commission had not adequately justified its decision to rely on cost accounting safeguards to protect against cross-subsidization.

In response, the FCC adopted the BOC Safeguards Order, which purported to explain why independent ESPs would not be unduly harmed by elimination of the separate subsidiary requirement.[9] But, on review, the Ninth Circuit Court of Appeals once again found fault with the Commission for failing to explain why removal of the structural separation requirement would be in the public interest. This time, the Court focused on potential BOC discrimination against ESPs in light of the Commission's failure to live up to representations that BOC networks would be fundamentally unbundled as a condition precedent to lifting the separate subsidiary requirement. Although the Commission had recognized that its Open Network Architecture ("ONA") requirements, which were touted "as a key safeguard against access discrimination" in Computer III, were not technically attainable, the Court noted that the Commission had failed to adjust its cost-benefit analysis accordingly.[10]

(California I); Phase II Order, 2 FCC Rcd 3072 (1987) (Phase II Order), recon., 3 FCC Rcd 1150 (1988) (Phase II Further Reconsideration Order), Phase II Order vacated, California v. FCC, 905 F.2d 1217; Computer III Remand Proceedings, 5 FCC Rcd 7719 (1990) (ONA Remand Order), recon., 7 FCC Rcd 909 (1992), pets. for review denied, California v. FCC, 4 F.3d 1505 (9th Cir. 1993); Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, 6 FCC Rcd 7571 (1991) (BOC Safeguards Order); BOC Safeguards Order vacated in part, California v. FCC, 39 F.3d 919.

8 California I, 905 F.2d 1217.

9 BOC Safeguards Order, 6 FCC Rcd. 7571 (1991).

10 California III, 39 F.3d 919.

III. A LEC's TITLE VI CABLE OPERATIONS OR TITLE II VIDEO PROGRAMMING OFFERINGS SHOULD BE PROVIDED THROUGH A SEPARATE SUBSIDIARY

It is unlikely that the Commission could make the cost-benefit showing required by the Ninth Circuit, even with regard to LEC provision of enhanced services in general. As the Court noted, "the BOCs have the incentive to discriminate and the ability to exploit their monopoly control over the local networks to frustrate regulators' attempts to prevent anticompetitive behavior."[11] Moreover, the Court expressed deep skepticism about the Commission's analysis of the costs of structural separation. Indeed, it stressed that the only concrete example the FCC has ever given to support its concerns about one of the "costs" at issue -- discouragement of innovation -- was the alleged prevention of the development of the voicemail market for small customers.[12]

But, even if the Commission could satisfy the Court with regard to the benefits of eliminating structural separation for the provision of most enhanced services -- a proposition that we strongly doubt -- the cost-benefit analysis weighs heavily in favor of structural separation for BOC provision of cable operations pursuant to Title VI or video programming pursuant to Title II. Without separate subsidiaries for such LEC activity, the risk of undetected anticompetitive behavior is simply too great.

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[11] Id. at 929.

[12] Id. at 925.

A. Local Exchange Carrier Provision of Cable Operations <u>Under Title VI and Video Programming Pursuant to Title II</u>

Under Section 613(b) of the Cable Act of 1984,[13] local exchange carriers are precluded from providing video programming directly to subscribers in their local service areas. A number of courts, however, have recently held the telephone company-cable television cross-ownership ban unconstitutional and, pending appeal, nearly all telephone companies may provide in-region cable service. Thus, the Commission is now faced with the unique circumstance of dominant local exchange carriers proposing to offer not only basic telephone service and VDT service, but also cable service on a universal basis over an integrated facility.

Where LECs are able to provide their own cable services, under a Title II or Title VI construct, the LEC incentives and opportunities for anticompetitive conduct multiply even beyond those existing when the LECs provide "pure" VDT over integrated facilities. As a result, in our comments in the Fourth FNPRM in the video dialtone proceeding, we not only emphasized that when a telephone company provides its own video programming directly to subscribers its video operations must be subject to the Title VI regulatory scheme, but we also demonstrated that additional safeguards are needed to protect against access discrimination and cross-subsidization by LECs that provide their own video programming to subscribers.[14] As noted therein, structural separation between a LEC's common carrier services and non-common carrier video offerings is

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13 47 U.S.C. § 533(b).

14 <u>See</u> Comments of the National Cable Television Association, Inc. CC Docket No. 87-266, filed March 21, 1995, at 8-32, 3-55.

absolutely essential to help the Commission detect and deter LEC anticompetitive behavior.[15]

B. Cost/Benefit Analysis

1. Anticompetitive Behavior is Likely

Local telephone companies are monopoly providers of essential and unique facilities and, as such, have a powerful capability to utilize their regulated resources to benefit their competitive services. In the video marketplace, where telcos have eagerly sought entry, the incentive to use network facilities to the detriment of competing service offerings is likely to be especially strong.

As the Ninth Circuit observed, LECs have demonstrated their ability to exploit the control they have over monopoly enterprises to thwart regulators' attempts to deter such anticompetitive behavior.[16] Without separate subsidiaries for the provision of LEC video services, it would be difficult at best to detect anticompetitive conduct. LECs could favor their own cable operations through preferred access to required network functions, lower rates, and discriminatory physical collocation of headend equipment. In addition, the use of joint inbound telemarketing and operating company personnel could give LECs a significant upper hand in launching their cable operations. Moreover, the LECs' preferred access to customer proprietary network information ("CPNI"), such as data on network usage, billing and service, generated by video information providers,

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[15] Id. at 37-38.

[16] California III, 39 F.3d at 929, citing In the Matter of the Commission's Investigation into Southern Bell Telephone and Telegraph Company's Trial Provision of Memory Call Service, Docket No. 4000-U (Ga. PSC, June 4, 1991).

service data about competing providers on the LEC network, and data about subscribers connected to the network, invites unwarranted discrimination.

Significantly, while the Court in California III held that the Commission had responded to its concerns about cross-subsidization between regulated and nonregulated services, it did not have the opportunity to consider this issue in the context of LEC cable operations. In fact, the relative inelasticity of the telephone service offering and the high proportion of common costs reflected in the joint offering of cable operations and telephone services makes the dangers of cross-subsidization particularly acute. In sum, the anticompetitive risks associated with LEC provision of competitive cable television service -- an issue not addressed in earlier Computer III decisions -- are significant and suggest that a separate subsidiary requirement is called for.

2. The Benefits of a Nonstructural Approach are Minimal

Under California III, removal of the separate subsidiary requirement is lawful only if the Commission can demonstrate that the benefits of a nonstructural approach outweigh the risks of anticompetitive behavior.[17] As shown above, when a LEC provides non-common carrier cable facilities and services, or video programming under the VDT regime, the risks of such behavior are substantial. In contrast, the benefits of a nonstructural approach in such circumstances are minimal.

In the context of enhanced services, the Commission argued, based largely on its experience with voicemail, that structural separation discouraged innovation

[17] California III, 39 F.3d 919.

and undermined efficiency.[18] However, the Ninth Circuit "was less than laudatory in [its] assessment of the FCC's analysis . . . and expressed concern that the only concrete example the FCC used to support its cost analysis was voice mail."[19] Regardless of the relevance of the voicemail experience to the FCC's cost-benefit analysis -- and we believe it is slight -- that analysis is simply not applicable to the video business.

Any purported LEC showing of "efficiencies" in the video services context would be based primarily on their desire to gain an unfair advantage over the competition. As noted above, there is no legitimate reason to permit carriers to leverage their pre-existing relationship with telephone customers, or to use ratepayer-funded expertise in research and development, to create new services or changes in network design that will aid their video operations.

Furthermore, the Commission's previously-expressed concerns about the costs of converting an integrated entity to a structurally separated system are nonexistent here since LECs are just beginning to enter the video business. Accordingly, structural separation will result in relatively slight transitional expenses borne by LEC cable customers, no disruptions in service and no customer confusion.

Finally, the Commission should not be deterred from establishing this important safeguard by concern that structural separation will deter rural LECs from entering the cable business. It may well be appropriate for the FCC to conclude that the costs of structural separation for rural and other small telephone

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[18] See, e.g., BOC Safeguards Order, 6 FCC Rcd. at 7575.

[19] California III, 39 F.3d at 925 (referring to the Court's earlier discussion in California I).

companies outweigh the risk of anticompetitive behavior. If it so concludes, it can do so based on an appropriate record. But those specific situations should not inhibit the Commission from adopting a general rule requiring structural separation where LECs offer cable television.

IV. CONCLUSION

NCTA recognizes that structural separation by itself can not prevent LEC anticompetitive conduct in the provision of cable television. Nevertheless, because of the increased incentives and opportunities for such behavior when LECs provide their own competitive offerings, a separate subsidiary requirement will enhance the ability of regulators to detect anticompetitive practices and anticonsumer behavior. Therefore the Commission should require that LECs conduct these operations through structurally separate subsidiaries.

Respectfully submitted,

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April 7, 1995

CERTIFICATE OF SERVICE

I, Staci M. Pittman, do hereby certify that on this 7th day of April, 1995, copies of the foregoing "**Comments of the National Cable Television Association, Inc.**" were delivered by first-class, postage pre-paid mail upon the attached list:

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